No. 89-1368

Supreme Court, U.S.
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IN THE

Supreme Court Of The United States

OCTOBER TERM, 1989

GULF STATES UTILITIES COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT BRIEF OF RESPONDENTS SOUTHERN COMPANY SERVICES, INC., ALABAMA POWER COMPANY, GEORGIA POWER COMPANY, GULF POWER COMPANY AND MISSISSIPPI POWER COMPANY IN OPPOSITION TO THE PETITION

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QUESTIONS PRESENTED

Through long-term power sale contracts, freely negotiated at arms length between unaffiliated utilities, Southern Companies (Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company and Southern Company Services, Inc.) committed to construct certain dedicated generating units and to provide specified capacity and energy from those units in accordance with the contract terms. The buyer, Gulf States Utilities Company ("Gulf States"), committed to take such capacity and energy over a specified term, and to pay rates based upon Southern Companies' cost of providing the service. Southern Companies have fulfilled their contractual commitments in every respect. The questions presented are:

1. Under section 206 of the Federal Power Act, 16 U.S.C. § 824e, did the Federal Energy Regulatory Commission ("Commission" or "FERC") err in refusing to abrogate these contracts (which would have shifted the cost responsibility back to the customers and stockholders of Southern Companies) in response to state commission decisions in Texas and Louisiana: (i) denying adequate retail rates associated with Gulf States' newly constructed River Bend Nuclear Plant, thereby causing its overall financial condition to be weakened; and (ii) ordering Gulf States to cease passing through to its retail customers the purchase costs associated with the contracts with Southern Companies due to alleged "imprudence" on the part of Gulf States?

2. Under section 206 of the Federal Power Act, 16 U.S.C. § 824e, did the Commission err in refusing to abrogate these contracts in response to claims by Gulf States that the purchases had become uneconomic or otherwise undesirable from its perspective, particularly when FERC found, as a matter of fact, that there was no "mismatch" of benefits and burdens between the parties or any other non-cost factor that would justify that requested relief?

3. Did the Commission err in its determination that, based on the circumstances and evidence presented, abrogating these contracts would undermine important policy goals under the Federal Power Act, including preserving the stability and integrity of contracts in the electric utility industry?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the appeal before the United States Court of Appeals for the District of Columbia Circuit were:

1. Gulf States Utilities Company — Petitioner
2. Federal Energy Regulatory Commission — Respondent
3. Southern Company Services, Inc. — Intervenor
4. Alabama Power Company — Intervenor
5. Georgia Power Company — Intervenor
6. Gulf Power Company — Intervenor
7. Mississippi Power Company — Intervenor
8. Louisiana Public Service Commission — Intervenor
9. Sam Rayburn G & T Electric Corporation, Inc. — Intervenor

Southern Company Services, Inc., Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company are all wholly owned subsidiaries of The Southern Company, a public utility holding company registered under the Public Utility Holding Company Act of 1935. Savannah Electric and Power Company, which became a wholly owned subsidiary of The Southern Company in 1988, is not a signatory to the contracts and therefore was not a party before the Commission or in the subsequent appeal.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES AND RULE 28.1 LIST	iii
TABLE OF CONTENTS	iv
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	2
JURISDICTION	2
GOVERNING STATUTORY PROVISION	2
STATEMENT OF THE CASE	2
A. Nature of the Case	3
B. Background and Nature of the Contracts	7
C. Proceedings before the Commission	12
D. Southern Companies' Performance/ Gulf States' Refusal to Pay	15
SUMMARY OF ARGUMENT	18
REASONS WHY THE PETITION SHOULD BE DENIED	19
A. The Commission Correctly Declined to Abdicate Its Regulatory Responsibility in Favor of Gulf States' Retail State Commissions	19
1. *The Contracts Are Not the Cause of Gulf States' Financial Condition*	19
2. *The Contracts Are Not Rendered Unjust and Unreasonable by Virtue of Unfavorable Retail Rate Treatment*	21

TABLE OF CONTENTS — (Continued)

Page

B. The Commission Applied Well-Established Standards in Evaluating Gulf States' Complaint 23

C. Gulf States Seeks Review of a Routine Contract Dispute 24

CONCLUSION 27

TABLE OF AUTHORITIES

Judicial Decisions: *Page*

Boroughs of Ellwood City v. Federal Energy Regulatory Commission, 731 F.2d 959 (D.C. Cir. 1984) 24

Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission, 734 F.2d 1486 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984) 23, 24

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) 23

Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) 23

Federal Power Commission v. Sierra Pacific Power Co., 350 U.S. 348 (1956) 19, 23, 24, 25

Mississippi Industries v. Federal Energy Regulatory Commission, 808 F.2d 1525 (D.C. Cir.), *rev'd and remanded in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987) 4, 6, 22

NAACP v. Federal Power Commission, 425 U.S. 662 (1976) 6

United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 25

Administrative Decisions:

Middle South Services, Inc., 30 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,030 (1985) 6

Ohio Edison Co., 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,344 (1983) 23

TABLE OF AUTHORITIES — (Continued)

Administrative Decisions: *Page*

Pacific Power & Light Co.,
27 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,080 (1984) 23

Pennsylvania Power & Light Co.,
23 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,006, *reh'g denied*,
23 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,325 (1983) 5, 21, 23, 25, 26

Philadelphia Electric Co.,
15 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,264 (1981) 26

Southern Co. Services, Inc.,
22 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,047 (1983) 9, 10

Southern Co. Services, Inc.,
26 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,360 (1984) 11

Southern Co. Services, Inc.,
44 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,290 (1988) 17

Western Massachusetts Electric Co.,
23 Fed. Energy Reg. Comm'n Rep.
(CCH) ¶ 61,025 (1983) 5, 22, 26

Statutes:

Federal Power Act, § 206(a),
16 U.S.C. § 824e(a) ..... *passim*

28 U.S.C. § 1254(1) 2

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Respondents Southern Company Services, Inc., Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company ("Southern Companies") request that this Court deny the petition for a writ of certiorari seeking review of the unreported judgment, filed September 22, 1989, of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

The opinions below are identified in the petition ("Pet.") filed by Gulf States Utilities Company ("Gulf States"), and are reprinted in the appendix thereto ("Pet. App.").

JURISDICTION

The judgment of the court of appeals was filed on September 22, 1989, (Pet. App. at 1a), with a petition for rehearing and a suggestion for rehearing en banc being denied by orders filed November 27, 1989. (Pet. App. at 2a, 3a). The petition for a writ of certiorari, invoking the jurisdiction of this Court under 28 U.S.C. § 1254(1), was filed on February 26, 1990.

GOVERNING STATUTORY PROVISION

The statutory provision governing this matter is section 206(a) of the Federal Power Act, 16 U.S.C. § 824e(a), as set forth in Gulf States' petition. (Pet. at 2-3).

STATEMENT OF THE CASE

In its petition, Gulf States begins with a lengthy and purportedly factual statement of the nature, history and purpose of the contracts underlying this dispute. That self-serving recitation is nothing more than an argumentative replication of its evidentiary presentation below, a presentation that in all material respects was found to be unpersuasive and unavailing.[1] For an objective and balanced state-

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[1]Gulf States' petition is littered with factual assertions that have been found to be untrue, first by the Administrative Law Judge and then by the Commission. The most prominent of these (indeed, the very foundation for the petition) is the repeated claim that the contracts are producing an "unintended, inefficient and unfair distribution of benefits and burdens" between the buyer and the seller. (*See, e.g.*, Pet. at i, 3, 5, 14, 15, 19, 25, 28). The record below firmly establishes, however, that no such "mismatch" exists, that the "benefits/burdens" analysis sponsored by Gulf States was conceptually flawed and incomplete, and that Gulf States has received and would continue to receive benefits from the contracts. (Pet. App. at 74a-82a, 13a-18a). In a transparent attempt to finesse this fatal evidentiary

ment of the facts, Southern Companies commend to the Court that portion of the initial decision entitled "Factual Background." (Pet. App. at 41a-49a). There, the FERC Administrative Law Judge ("ALJ") has accurately summarized the rather extensive background facts and, when necessary, has resolved conflicting factual assertions by the parties.

Although satisfied with the ALJ's statement of the facts, Southern Companies will, in the interest of completeness, briefly discuss: (i) the nature of the case; (ii) the historical background leading to the execution of the contracts and their initial approval by the Commission; (iii) the proceedings before the Commission; and (iv) the performance (or, in the case of Gulf States, the lack of performance) of the parties during the pendency of those proceedings.

A. Nature of the Case

This petition centers on two wholesale electric power supply contracts between Southern Companies (the sellers) and Gulf States (the buyer): the Unit Power Sales Agreement ("UPS Agreement") and Service Schedule E to the Interchange Contract[2] ("Schedule E"). "Unit power" is a type of sale involving the dedication of a discrete portion of a

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failure, Gulf States repeatedly chides the Commission for its "purported" examination of the facts. (*See, e.g.*, Pet. at 12, 20 n.27).

Another noteworthy factual inaccuracy is the claim that "Gulf States established that relief from the contract at issue is essential to its financial viability," and that FERC "refused to consider" this effect on Gulf States' financial position. (Pet. at 5). In making this assertion, Gulf States simplistically equates an adverse result below with a failure on the part of FERC to "consider" its arguments. In truth, the evidence "overwhelmingly establishes" that its financial difficulties are traceable to the need for retail rates to cover the River Bend Nuclear Plant, and not to the contracts with Southern Companies. Moreover, it was proven that the financial problems would not be solved even if these contracts were abrogated. (Pet. App. at 82a-87a, 18a-21a).

[2]An interchange contract establishes the terms and conditions governing the physical connection of the parties' respective electrical systems. Customarily appended to an interchange contract are several service schedules pertaining to various types of transactions that may occur from time to time between the parties.

specified generating unit (or units) to the exclusive use of the purchaser, and entails both capacity[3] and energy[4] components. Schedule E provides for the sale of "long-term power" out of a mix of generating units, and is subject to interruption under specified circumstances. This transaction likewise involves both capacity and energy. Both the UPS Agreement and Schedule E were the product of arms-length negotiations between completely unrelated and unaffiliated commercial entities.[5] Indeed, the electrical systems of Southern Companies and Gulf States had never been physically connected prior to the execution of the UPS Agreement.

Although initially couched in terms of contract "modification," Gulf States has first asked the ALJ, then the Commission, next the court of appeals and now this Court to abrogate its freely-assumed obligations under contracts that it no longer finds sufficiently beneficial or advantageous. To make this plea, Gulf States focuses exclusively on *its* customers, *its* stockholders, *its* financial difficulties and *its* retail regulatory problems, and castigates the Commission for failing to respond to these concerns. In so doing, however, Gulf States neatly omits any mention of the counterbalancing impact of contract abrogation on the customers, stockholders, financial conditions and retail regulatory situations of Southern Companies. Granting the relief sought by Gulf States would not cause the fixed (or "sunk") costs associated

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[3]"Capacity" means the power generation capability available from an electric generating facility or group of facilities.

[4]"Energy" means the electricity produced through the utilization of capacity.

[5]In its petition, Gulf States vainly attempts to draw support from the decision in *Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir.) ("*Mississippi Industries*"), *rev'd and remanded in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987). (Pet. at 14 n.17, 28). Unlike the Southern Companies-Gulf States transaction, however, the contract at issue in *Mississippi Industries* involved affiliated operating companies of the same holding company that for many years had planned, built and operated on a totally integrated basis. Under such circumstances, the court affirmed the Commission's determination that it would be discriminatory under section 206 to permit one of the four operating companies to escape all cost responsibility for a nuclear plant that it, along with the other affiliated companies, had jointly agreed to build.

with the generating units contractually dedicated to Gulf States to disappear, but instead would only shift these costs to Southern Companies (which have fully complied with their end of the bargain). The fixed costs associated with these plants *will* be borne by someone — the only question is, by whom?[6]

Heeding overwhelming public policy considerations, both the ALJ and the Commission rejected Gulf States' untenable notion that the Commission should engage in regional protectionism by abrogating contracts on the basis of relative size and wealth of the litigants. The Commission cannot (and should not) be placed in the impossible position of deciding whether the customers in one region of the country are in a better position to pay (or absorb) costs than are customers who are located in another region of the country. As recognized by the ALJ and adopted by the Commission:

> The mere fact that Southern is larger does not establish that Southern would be any less damaged by the assumption of the capacity at issue than GSU would be, even if it were found that GSU was entitled to relief. In addition, it would not be desirable, as a matter of Commission policy, to favor one utility over another or to favor one region over another based upon the utilities' comparative sizes or a determination of relative need.

(Pet. App. at 89a, *adopted*, Pet. App. at 11a). The wisdom of this policy judgment, which is consistent with Commission precedent, is self-evident. *See, e.g., Western Massachusetts Electric Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025, at 61,064 (1983); *Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325 (1983).

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[6]Before the court of appeals and now, Gulf States has chosen to ignore the import of this question. More candid in this regard was its position before the ALJ and the Commission, where Gulf States flatly contended that Southern Companies were better able to "absorb" these costs for reasons including their relative sizes, financial conditions and local economic circumstances.

While conceding that the contracts are strictly cost-based, Gulf States doggedly insists that "non-cost factors" justify contract abrogation, and that the public interest would somehow be served thereby. The problem with this approach is Gulf States' totally self-serving view of the public interest, which in truth is neither company-specific to Gulf States nor regionally restricted to its service territory. As recognized in the initial decision:

> GSU's requested relief, which is tantamount to contract abrogation, and the theories upon which GSU rests its claim are fraught with negative public interest implications. Permitting contract abrogation in the circumstances herein would undermine the sanctity of contracts and in doing so, would create contractual instability in the electric utility industry. . . . Thus, even if the contracts herein did adversely impact the public interest, which they do not, the greater public interest in maintaining the stability and integrity of electric utility contracts would far outweigh GSU's perceived public interest.

(Pet. App. at 91a). *See NAACP v. Federal Power Commission*, 425 U.S. 662, 669-70 (1976).

Gulf States' plea that the Commission should have abrogated the contracts because its local retail regulators have disallowed pass-through of the resulting costs would, if accepted, render the Commission subservient to the "necessarily parochial concerns of the States." *Mississippi Industries*, 808 F.2d at 1549 (quoting *Middle South Services, Inc.*, 30 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,030, at 65,151 (1985)). Similarly, shifting the contract costs back to Southern Companies in order to ease financial difficulties that are directly attributable to inadequate retail rate treatment for Gulf States' River Bend Nuclear Plant would, in essence, cause the customers and stockholders of Southern Companies to subsidize the cost of that plant. FERC properly declined to abdicate its regulatory function in this manner, and instead evaluated the contracts under well-recognized standards governing section 206 of the Federal Power Act. With cost recovery as the starting point, the various "non-cost

factors" identified by Gulf States were separately evaluated in light of the evidence, precedent and public policy (including due regard for the interests of Southern Companies). When so tested, each such factor was found to be wanting.

B. Background and Nature of the Contracts

Until the early 1970s, Southern Companies (like other electric utilities in the United States) had experienced relatively stable and predictable load growth, and had made generation planning decisions in accordance therewith. Beginning in the early 1970s, however, Southern Companies began experiencing annual decreases in their load forecasts. It thus became necessary to adjust existing generation expansion plans by deferring or cancelling units that were no longer needed. By the late 1970s, the prospect of additional delays or cancellations was looming, even though such would result in additional costs at a later time.

In response to these conditions, Southern Companies began a concerted effort to sell capacity and energy to neighboring utilities. This initial effort only resulted in sales of long-term power (Schedule E) that produced insufficient revenues to support continuation of certain coal-fired generating units then under construction. In order to justify the tremendous investment needed to continue construction of those units, Southern Companies determined that unit power sales were required, and consequently focused their marketing strategy on the sale of unit power.[7]

In 1981, Southern Companies consummated UPS Agreements with Florida Power & Light Company ("FPL") and Jacksonville Electric Authority, but, despite this 1,400

[7]Schedule E capacity sales are generally priced on the basis of the embedded cost of the entire electric system, which (because it reflects the depreciated cost of both old and new units) is typically lower than the cost of constructing new generation. In contrast, the capacity pricing in a unit power sale is calculated to recover the full incremental cost of the dedicated unit.

megawatt ("MW") sale, faced serious problems justifying continued construction of various generating units on their existing schedules. Compounding this problem were the financial and retail regulatory difficulties being experienced by the two largest operating companies (Alabama Power Company and Georgia Power Company) associated with nuclear facilities that had just been completed (Farley Nuclear Plant) or were still under construction (Vogtle Nuclear Plant). It was at this time that Gulf States approached Southern Companies regarding the possibility of a long-term capacity purchase.

While Southern Companies were confronted with the prospect of having to delay or cancel generating units, Gulf States was facing a serious power supply deficit and substantial uncertainties regarding the cost and availability of its primary fuel source, natural gas. According to Gulf States, its major alternatives were to: (i) build additional generation; (ii) build new transmission facilities and import power; or (iii) leave its customers exposed to the uncertainties associated with using oil and natural gas as the primary fuel supply. While leaving its customers exposed to fuel supply uncertainties was not a viable alternative for Gulf States, neither did it favorably view the construction option because of its already strained financial and management resources associated with the ongoing construction of the River Bend Nuclear Plant. Gulf States was nevertheless considering the construction or lease of two 500 MW coal-fired units. The purchased power option was ultimately elected, and Southern Companies were determined to be the lowest cost suppliers.[8]

On February 25, 1982, Southern Companies and Gulf States executed the UPS Agreement pursuant to which Gulf States committed to buy and Southern Companies committed to sell 500 MW of unit power capacity over the period 1984 through May, 1992. On that same date, the parties also

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[8]The only other viable purchase option identified by Gulf States was unit power out of Middle South's Grand Gulf Nuclear Plant. If consummated, this purchase would have been far more costly to Gulf States than the purchase of coal-fired capacity from Southern Companies.

executed the Interchange Contract. The unit power sale to Gulf States, coupled with additional unit power sales to FPL[9] and a contemplated sale to Houston Lighting & Power Company ("HLP"), enabled Southern Companies to commit additional coal-fired generating units to the unit power sale program, thereby allowing the construction of those units to proceed on schedule.

Approximately one month after the execution of the UPS Agreement with Gulf States, HLP advised Southern Companies that it would be unable to make its contemplated 500 MW purchase of unit power capacity. On that very same day, Gulf States requested to purchase this additional unit power capacity. In accordance with Gulf States' request, the parties, on May 12, 1982, executed Amendment No. 1 to the UPS Agreement pursuant to which Gulf States increased the amount of unit power capacity it was purchasing from 500 MW to 1,000 MW.

As a consequence of the UPS Agreement with Southern Companies, Gulf States avoided investing time and money in a construction program for coal-fired units, and instead focused its financial and management resources on completing the River Bend Nuclear Plant. The burden of financing and building other capacity was contractually borne by Southern Companies. This corporate strategy on the part of Gulf States was announced in an address to its shareholders on May 13, 1982 — just one day after Amendment No. 1 to the UPS Agreement was signed.

In accordance with the requirements of the Federal Power Act and the Commission's rules and regulations, Southern Companies, on June 7, 1982, filed the UPS Agreement and the Interchange Contract with FERC. The Commission accepted the contracts for filing and instituted an investigation pursuant to section 206 of the Federal Power Act. *Southern Co. Services, Inc.*, 22 Fed. Energy Reg. Comm'n Rep.

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[9]As a consequence of the impending sale to Gulf States and pursuant to contractual rights contained in its UPS Agreement, FLP exercised an option to purchase additional unit power capacity from Southern Companies.

(CCH) ¶ 61,047 (1983). There were several intervenors in that proceeding, including Gulf States and the Louisiana Public Service Commission.

Under Section 1.1 of the UPS Agreement, Gulf States committed to "cooperate and assist Southern Companies in securing conclusion of the initial review by FERC of this Agreement without significant change hereto, in an expeditious manner." Notwithstanding that contractual commitment, however, Gulf States advised Southern Companies in a September, 1983 meeting that it would not be able to support the contract because of "changed circumstances." These circumstances included declining prices and increased availability of natural gas, anticipated difficulties with its retail commissions in Texas and Louisiana involving the soon-to-be-completed River Bend Nuclear Plant, the depressed economy in Gulf States' service territory and Gulf States' reduced load forecast indicating no further need for the capacity.

To address these concerns and to resolve the proceeding before the Commission, Southern Companies and Gulf States entered into a settlement agreement whereby capacity sales under the UPS Agreement were delayed and reduced to 0 MW, 400 MW, 500 MW and 600 MW for the years 1984, 1985, 1986 and 1987, respectively, and 700 MW for the years 1988 through May, 1992. Schedule E was added to the Interchange Contract, and Gulf States agreed to purchase lower cost long-term power thereunder in amounts corresponding to those deleted from the UPS Agreement. The parties also amended the UPS Agreement by adding Section 2.2.4 (providing that the amount of UPS capacity may increase, "but in no event decrease," due to changes in natural gas prices) and Section 2.2.5 (allowing Gulf States to relieve itself of the purchase obligation by finding an alternate purchaser). Southern Companies further agreed to a reduction in the return to be earned on common equity capital invested in the dedicated UPS units. The financial impact of these concessions, which are embodied in Amendment No. 2 to the UPS Agreement and Amendment No. 1 to the Interchange Contract, was a capacity-related

revenue loss to Southern Companies of approximately $350-400 million. The total adverse economic impact on Southern Companies was substantially greater if fuel-related costs are taken into account.

The above-described settlement agreement was filed with the Commission on December 8, 1983. By order issued March 23, 1984, the Commission approved that settlement, finding the contracts to be "just and reasonable and in the public interest." *Southern Co. Services, Inc.*, 26 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,360, at 61,796 (1984).

While the filing was pending before the Commission and thereafter, Southern Companies continued to construct the designated generating units from which capacity was contractually dedicated to Gulf States. Gulf States does not contend or even imply that Southern Companies have in any way failed to perform their contractual commitments with respect to the provision of capacity and energy under the UPS Agreement or Schedule E.[10] Indeed, Southern Companies' performance under the contracts has exceeded expectations, in that the actual cost of capacity and energy provided under the UPS Agreement and Schedule E has been lower than projected in 1981 and 1983. Further, Southern Companies in 1985 offered (and Gulf States accepted) Service Schedule R to the Interchange Contract, which enabled Gulf States to lower its energy costs under the UPS Agreement.

As the River Bend facility neared completion, retail regulatory pressure from the Texas and Louisiana commissions began to mount. By letter dated January 8, 1986, Gulf States requested that Southern Companies commence negotiations for consideration of "the elimination or suspension of capacity sales and purchases under the [UPS] agreement" pursuant to Section 2.2.1 thereof. That section provides:

> In the event either party desires to increase or decrease capacity sales or purchases for the years set

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[10]Although Gulf States raised a vague contention in its section 206 complaint regarding the availability of Schedule E, the contention was expressly abandoned during the evidentiary hearings.

> forth above, the parties agree to negotiate in good faith and with diligence to proceed to evaluate alternatives which may reasonably provide for such desired change in capacity; provided, that no such change shall be made except upon mutual written agreement of the parties hereto.

A series of meetings and telephone conferences subsequently took place, during the course of which Gulf States suggested modifying the contracts in a manner that was totally advantageous to Gulf States and totally detrimental to Southern Companies. Southern Companies' evaluation of these suggestions included a quantification of their adverse financial impact, which ranged from $250-600 million in lost capacity payments alone.[11] In response, Southern Companies offered several alternatives, specifically including a deferred payment proposal designed to address cash flow, which Gulf States had previously identified as its most pressing problem.

Gulf States abruptly terminated the negotiations by filing suit against Southern Companies in the United States District Court for the Eastern District of Texas (Beaumont Division). In conjunction therewith, it obtained permission from the district court, pursuant to rule 67 of the Federal Rules of Civil Procedure, to deposit into the registry the capacity and energy payments that were otherwise due Southern Companies under the contracts. Thereafter, Southern Companies, on August 25, 1986, petitioned the Commission for a declaratory order to terminate this controversy and to remove uncertainty concerning these FERC-approved contracts. Three days later, Gulf States filed its complaint under section 206 of the Federal Power Act.

C. Proceedings before the Commission

At the behest of Gulf States, consolidated proceedings involving Southern Companies' petition and Gulf States' complaint were conducted on an expedited basis before the

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[11]Gulf States' chief negotiator admitted that Gulf States never evaluated the financial loss to Southern Companies under any of its suggestions.

ALJ. During the course of over three weeks of evidentiary hearings, the parties compiled a record consisting of approximately 4,000 pages of transcript and hundreds of exhibits. With regard to its section 206 complaint, Gulf States conceded that the rates and charges under the contracts recovered only Southern Companies' cost of providing the service, but nevertheless argued that the contracts had been rendered unjust and unreasonable due to a variety of "non-cost factors." These factors, together with the findings and conclusions related to each, can generally be summarized as follows:

"Non-Cost Factor"	**Findings and Conclusions**
1. Unforeseen Changed Circumstances (natural gas prices and availability; lack of need).	— Identified and addressed by the parties in 1983 amendments. — Contractual risk was assumed by Gulf States. (Pet. App. at 73a-74a)
2. "Mismatched" Benefits and Burdens.	— Parties did not contemplate an entitlement to perpetual contractual benefits. — Gulf States received the bulk of its bargained-for benefits. — Southern Companies received no more than their cost of providing the service. — Gulf States' supporting benefits/burdens analysis was conceptually flawed, incomplete and inaccurate. (Pet. App. at 74a-82a).
3. Weakened Financial Condition.	— Principal cause is the need for retail rate relief associated with River Bend, not the contracts with Southern Companies.

"Non-Cost Factor"	Findings and Conclusions
	— Abrogating the contracts would not cure Gulf States' financial problems or assure its ability to provide reliable service. (Pet. App. at 82a-88a).
4. Retail Commissions' Refusal to Pass Through the Contract Costs.	— Parties did not intend performance under the contracts to be contingent on favorable retail rate treatment. — Southern Companies should not bear the cost of either imprudence by Gulf States or arbitrary actions by its state commissions. (Pet. App. at 102a-108a).
5. Southern Companies' Reliance on the Contracts to Build the Dedicated Units.	— Relevant question is not Southern Companies' reliance, but whether they have fulfilled their obligations, incurred costs in doing so and recovered no more than those costs through the contract rates. — Overwhelming evidence establishes Southern Companies' reliance on the contract revenues to continue unit construction. (Pet. App. at 114a-116a).
6. Southern Companies' Need for Capacity.	— Southern Companies' reserves are adequate. — Gulf States failed to prove any capacity need by Southern Companies. (Pet. App. at 116a-117a).

"Non-Cost Factor"	Findings and Conclusions
7. Southern Companies' Comparative Size.	— Relative size of litigants is not a legitimate consideration where contracts were freely negotiated at arms length by two commercial entities. — Favoring one utility or region over another based upon comparative size or relative need would be undesirable for policy reasons. (Pet. App. at 88a-89a).

On appeal to the Commission, these findings and determinations were affirmed in all material respects. (Pet. App. at 10a-23a). Responding to Gulf States' further contention that the contracts "promote inefficiency and waste of resources because [Gulf States] can generate energy more cheaply from its own resources," the Commission observed that the alleged inefficiency was not due to any aspect or provision of the contracts, but rather was the result of external circumstances (natural gas prices and diminished load growth) that could reverse themselves in the future. In any event, the Commission determined that, as a matter of public policy under the Federal Power Act, the goal of preserving and promoting contract stability far outweighed such possibly transient concerns. (Pet. App. at 23a-25a).

D. Southern Companies' Performance/Gulf States' Refusal to Pay

Despite its district court suit and its section 206 complaint against Southern Companies, Gulf States continued to utilize the capacity under the UPS Agreement by scheduling and taking energy under the contract.[12] Recognizing these to be

[12]As an engineering matter, energy will not flow over the tie lines connecting separate utilities so long as the system load and system generation of each are relatively balanced. Thus, Gulf States was not being

filed rates that are subject to the exclusive jurisdiction of the Commission, Southern Companies continued fully to perform their obligations under the contracts. Nevertheless, Gulf States did not comply with the capacity and energy payment provisions of the contracts, as evidenced by the following summary of events:

1. Since July, 1986, Gulf States has made no capacity payments to Southern Companies under the UPS Agreement and Schedule E, but (as previously noted) did obtain permission from the federal district court to deposit the capacity payments otherwise due Southern Companies into the registry of the court. Gulf States declined to pay Southern Companies, even though it was collecting these capacity costs from its retail ratepayers in Louisiana[13] and from its wholesale customers subject to FERC jurisdiction.

2. Beginning in July, 1986, Gulf States paid to Southern Companies only a portion of the energy charges under the contracts representing Gulf States' so-called "avoided cost," with the balance of the energy charges being paid into the registry. At all times, Gulf States was collecting from its retail and wholesale customers the full energy charges otherwise due Southern Companies under the contracts.

3. In October and November of 1986, the Texas and Louisiana commissions disallowed the collection from Gulf States' retail ratepayers of capacity charges under its con-

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forced to take this energy as a result of some unilateral act on the part of Southern Companies. Rather, its system operators would call their counterparts at Southern Companies to coordinate decreased generation by Gulf States and increased generation by Southern Companies. Through such coordinated action, energy would flow from Southern Companies to Gulf States for the latter's use.

[13]In May, 1986, Gulf States agreed to a rate reduction in Texas of approximately $80 million, of which approximately $55 million was attributed to the capacity costs associated with the contracts with Southern Companies. Gulf States apparently did so in order to obtain from the Texas commission an order establishing favorable accounting treatment pertaining to the River Bend Nuclear Plant. The disallowance of pass-through of the contract costs was only temporary, pending resolution of an ongoing case concerning Gulf States' prudence in entering into those contracts.

tracts with Southern Companies. The Texas commission so ruled on the grounds that Gulf States had been "imprudent" when it initially entered into the contracts, whereas the Louisiana commission, focusing on the prior action taken by the Texas commission, determined that continued collection from Louisiana ratepayers would contravene the "doctrines of Fundamental Fairness and Equal Protection." Since that time, Gulf States has neither paid Southern Companies nor deposited into the registry any capacity charges associated with its retail jurisdictions. Gulf States did continue to pay into the registry those capacity charges under the contracts associated with its wholesale business regulated by FERC.

4. Beginning in February, 1987, Gulf States ceased to deposit into the registry the wholesale portion of the capacity charges owed Southern Companies and the balance of the energy charges owed Southern Companies. Gulf States stopped doing so despite the fact that it continued to collect *all* energy charges from retail ratepayers in Louisiana and Texas, and all energy *and* capacity charges from its wholesale customers.

5. Even after February, 1987, Gulf States continued to schedule and utilize the capacity and energy under the UPS Agreement, while at the same time paying Southern Companies *nothing* for the capacity and paying only a portion of the invoiced energy charges (which portion is *less than* Southern Companies' actual cost of producing the energy). This intolerable situation persisted until the Commission issued its April 1, 1988, opinion upholding the validity of the contracts and its June 1, 1988, order denying rehearing. At this point, Southern Companies wrote Gulf States to demand payment of all past-due capacity and energy charges, together with adequate assurance of Gulf States' future performance. When Gulf States refused, Southern Companies were forced to petition the Commission for permission to suspend their performance under the contracts, which request was granted effective July 1, 1988. *Southern Co. Services, Inc.*, 44 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,290 (1988).

SUMMARY OF ARGUMENT

The petition for a writ of certiorari should be denied because the Commission quite properly refused to allow the exercise of its regulatory jurisdiction to be dictated by the actions of Gulf States' retail commissions in Texas and Louisiana. The evidence undeniably shows that Gulf States' weakened financial condition is not caused by the contracts at issue, but rather is the direct result of the refusal of those commissions to grant adequate retail rates to cover the tremendous costs associated with the River Bend Nuclear Plant. Contract abrogation under such circumstances would have been tantamount to extracting a subsidy from the customers and stockholders of Southern Companies to help defray the costs of River Bend.

FERC likewise correctly determined that the refusal of Gulf States' state commissions to allow the pass-through of the contract costs to its retail ratepayers on the grounds of alleged "imprudence" by Gulf States had no bearing on FERC's application of section 206 to these wholesale power contracts. If the state commissions are correct and Gulf States was imprudent, then contract abrogation would, in effect, shift the financial impact of that managerial imprudence to the customers and stockholders of Southern Companies. If the disallowance is unjustified, however, then abrogating the contracts would burden Southern Companies with the financial impact of irresponsible actions on the part of Gulf States' retail regulators. Either way, the result would be patently unfair to Southern Companies.

Instead of abdicating its regulatory authority in favor of Gulf States' retail commissions, FERC applied well-established principles under section 206 of the Federal Power Act. Beginning with the foundational cost-based inquiry, the Commission satisfied itself that Southern Companies were receiving no more than a recovery of the costs they incurred in performing their contractual obligations to Gulf States. Recognizing that non-cost factors may be considered in establishing a just and reasonable rate, the Commission then proceeded to evaluate each and every such factor cited by Gulf States. In the end, the factors were found to

present an inadequate basis upon which to abrogate these contracts as a matter of fact, law and/or public policy.

Stripped of its rhetoric and lofty discussions of economic theory, Gulf States' petition brings to this Court a rather commonplace contract dispute of the sort that lower courts handle on a routine basis. True enough, the dollars involved are substantial and the contracts are subject to regulatory approval but, in the final analysis, Gulf States is just another dissatisfied party to a contract seeking to escape a bargain that (at least in its view) is no longer sufficiently beneficial. Pertinent in this regard is the Court's prior admonition that section 206 of the Federal Power Act cannot be utilized to relieve a utility of an "improvident bargain" or to render a seller's contract unjust or unreasonable "simply because it is unprofitable to the public utility." *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). Nevertheless, that is precisely what Gulf States sought to do in this case, and its request for contract abrogation was therefore denied. On appeal to the District of Columbia Circuit, that court affirmed the Commission a mere seven days following oral argument, commenting that "the petition does not warrant an opinion." (Pet. App. at 1a). Gulf States' petition to this Court is equally devoid of merit and should be denied.

REASONS WHY THE PETITION SHOULD BE DENIED

A. The Commission Correctly Declined to Abdicate Its Regulatory Responsibility in Favor of Gulf States' Retail State Commissions

1. *The Contracts Are Not the Cause of Gulf States' Financial Condition*

In its petition, Gulf States repeatedly references its weakened financial condition, thereby implying (but never quite saying) that the contracts with Southern Companies are the cause of that situation. Gulf States initially took that position; however, the evidence at the hearing clearly dem-

onstrated to the contrary.[14] As noted in the initial decision, the carrying costs and other costs associated with River Bend totalled approximately $900 million in 1987, an obligation that dwarfed the $132 million of capacity charges owed Southern Companies under the contracts. (Pet. App. at 84a-87a). In this regard, Southern Companies' evidentiary presentation showed that, if Gulf States were afforded reasonable retail rate relief associated with River Bend, then it could honor its contractual obligations to Southern Companies (even if the state commissions denied retail pass-through of the contract costs). Conversely, it was demonstrated that, absent adequate retail rate relief associated with River Bend, Gulf States could not survive, even if the contracts with Southern Companies were abrogated. In short, "[t]he evidence in the record overwhelmingly establishes that the principal cause of [Gulf States'] current financial difficulties is the failure of the state regulatory commissions to provide rate relief in connection with the River Bend Nuclear Plant . . . . " (Pet. App. at 87a, 18a-19a).

In conjunction with these determinations, the Commission specifically did not predicate its decision on any speculated level of retail rate relief. Rather, it refused, as a matter of public policy, to allow the exercise of its exclusive jurisdiction over wholesale arrangements to be "controlled by decisions made by state regulatory authorities exercising their proper authority over a utility's retail rates." (Pet. App. at 21a). Stated differently, FERC found untenable the notion that it should abrogate otherwise just and reasonable contracts in response to a financial condition that is directly traceable to

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[14]In its complaint, Gulf States contended that "the financial integrity of Gulf States is in jeopardy as a result of the Southern Companies agreements," and even went so far as to say that the possible denial of pass-through of the capacity charges was "[t]he greatest and most imminent threat to Gulf States' financial integrity." As the proceedings below progressed, Gulf States was forced by the evidence to downgrade this claim, ultimately asserting that the contracts are a "contributing factor" to its financial problems. In its petition to this Court, however, Gulf States has seemingly reverted to its original claim, representing that "Gulf States established that relief from the contract at issue is essential to its financial viability." (Pet. at 5).

the decisions of Gulf States' retail commissions. Moreover, had Gulf States addressed its anticipated capacity shortage by pursuing a "brick and mortar" construction program in 1982, rather than the purchase option from Southern Companies, it most assuredly could not have pursued the selective "abrogation" of its resulting financial obligations to vendors, contractors and investors. The Commission thus correctly declined to transform itself into the equivalent of a special bankruptcy court with only one creditor before it, namely Southern Companies.[15]

2. *The Contracts Are Not Rendered Unjust and Unreasonable by Virtue Of Unfavorable Retail Rate Treatment*

In its petition, Gulf States continues to argue (as it did to the Commission and to the court of appeals) that the disallowance of pass-through of the contract costs in retail rates by its Texas and Louisiana commissions should have led FERC to abrogate the contracts with Southern Companies. (Pet. at 9-10, 10 n.12, 19). Conspicuous by its absence is any supporting legal authority; indeed, governing Commission precedent is directly to the contrary. *See, e.g., Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325, at 61,715-16 (1983).

In the initial decision, the ALJ recounted in detail the history of state regulation pertaining to these contracts, and in particular the ever-changing treatment such purchased power expense has received at the hands of Gulf States' retail regulators. The Texas commission previously characterized the contracts with Southern Companies as being "necessary to ensure adequate reserve margins and to help reduce dependence on oil and gas based energy," and later found that the contracts would provide significant savings for Gulf

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[15]Granting the relief requested by Gulf States would obviously not relieve Southern Companies of obligations they incurred in connection with the contractually-dedicated generating units. Rather, the financial burden of paying vendors, contractors and investors would simply fall on their customers or stockholders, as opposed to the customers and stockholders of Gulf States.

States' customers. For its part, the Louisiana commission intervened and participated in the 1983 proceedings before FERC, and consented to the settlement agreement that resulted in approval of the contracts.

Notwithstanding these actions, both state commissions subsequently disallowed retail pass-through of the contract costs, generally on grounds involving alleged "imprudence" on the part of Gulf States. Perhaps those commissions truly believe that Gulf States was imprudent, or perhaps they are engaging in sheer parochialism by attempting to direct costs from their constituents to the customers of Southern Companies. Either way, FERC correctly refused to allow its section 206 analysis to be driven by these actions. If the state commissions are correct and Gulf States was imprudent, then granting relief to Gulf States would impose on Southern Companies the adverse effects of Gulf States' poor management. This would be wrong; it should be for the Texas and Louisiana commissions to decide whether the public interest of their constituents is best served by keeping Gulf States financially viable, notwithstanding its managerial imprudence.

On the other hand, if Gulf States was indeed prudent in entering into these contracts, then the effect of FERC abrogating them in response to state commission action would be to shift to Southern Companies the financial impact of irresponsible regulation in Texas and Louisiana. An important economic safeguard would be negated, because the customers and stockholders of Southern Companies (and not those of Gulf States) would bear the brunt of opportunistic state commission decisions and political brinkmanship. For these and other sound policy reasons, the Commission independently examined the contracts under section 206, and did not allow the exercise of its regulatory jurisdiction to be "controlled by the necessarily parochial concerns of the States." *Mississippi Industries,* 808 F.2d at 1549. *See also Western Massachusetts Electric Co.,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025, at 61,064 (1983).

B. The Commission Applied Well-Established Standards in Evaulating Gulf States' Complaint

Although Gulf States' petition strongly implies that the Commission's analysis of its complaint amounted to nothing more than a summary dismissal of its arguments and evidence as a matter of law, even a cursory scan of the underlying opinions of the ALJ and the Commission demonstrates to the contrary. In applying the just and reasonable standard under section 206, FERC began with the foundational inquiry of whether the rates and charges properly reflect the seller's cost of providing service, an interpretation that has been consistently applied since the very inception of the Federal Power Act. *See generally Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *See also Pacific Power & Light Co.*, 27 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,080, at 61,148 (1984); *Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325, at 61,716 (1983); *Ohio Edison Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,344, at 61,749 (1983). Not only is the cost-based nature of section 206 a logical and practical basis for regulation, it is fundamentally consistent with this Court's pronouncements that the just and reasonable standard equates to constitutional standards ensuring a fair return and proscribing confiscation. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942).

While the Commission has a certain degree of latitude in determining what constitutes a just and reasonable rate, cost recovery and a fair return remain the touchstone. As explained in *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission*, 734 F.2d 1486 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984), the phrase "just and reasonable" translates into a "zone of reasonableness," with the upper end of the zone approaching "excessive" and the lower end of the zone approaching "less than compensatory." 734 F.2d at 1502. Although non-cost factors may impact the ratemaking process, the resultant rates must

nevertheless fall within the zone of reasonableness. *See, e.g., Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (if the public interest so requires, FERC may modify a contract containing a below-cost fixed rate and allow the seller to increase the rate to provide for a fair return); *Boroughs of Ellwood City v. Federal Energy Regulatory Commission*, 731 F.2d 959, 975 n.24 (D.C. Cir. 1984) ("[T]he Commission's power to remedy a price squeeze was limited by the lower end of the zone of reasonableness."); *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission*, 734 F.2d at 1502-03 (non-cost factors do not allow the setting of rates above the zone of reasonableness). Such factors have never been applied in a manner that would deny the seller recovery of its prudently-incurred costs, which is the fate that Gulf States advocates for Southern Companies.

Apart from the fact that its legal position is contrary to overwhelming precedent, Gulf States is essentially urging this Court to engage in an academic exercise of statutory interpretation that, regardless of the outcome, would not change the result. This is because both the ALJ and the Commission engaged in a painstaking review of each and every non-cost factor identified by Gulf States, and determined that none of them provided any basis for contract abrogation. (Pet. App. at 73a-92a, 11a-25a). Under any legal standard, Gulf States' arguments fail as a matter of evidentiary fact.

C. Gulf States Seeks Review of a Routine Contract Dispute

Gulf States' petition brings to this Court a rather commonplace contract dispute of the sort that lower courts handle on a routine basis. Curious indeed is its protracted contention that FERC's decision creates some sort of "imbalance" between buyers and sellers in the bulk power market, as if the only way contractual risks can be avoided by a buyer is through after-the-fact regulatory intervention. (Pet. at 17-20). This is pure nonsense. The fundamental means of allocating risks like those identified by Gulf States is through

the negotiating and drafting process and through the related analysis leading to the management decision to enter into a contract. Thus, if Gulf States had expected absolute protection against unfavorable state retail rate treatment of the contract costs, it would have been a simple matter to require a "regulatory out" provision to achieve this end. Similarly, Gulf States could have chosen to negotiate a "market out" provision for the purpose of hedging against dramatic changes in the price of natural gas. Of course, Southern Companies would have had to agree to such risk-assigning provisions, and they likely would not have done so given the tremendous investment required for their performance. In any event, the assessment of such risks is an integral part of the analysis and bargaining process leading to a mutually-agreeable contract. When billion dollar commitments are at stake, the contractual allocation of risks simply cannot be subject to realignment through regulatory afterthought by one of the parties.

In the opinions below, both the ALJ and the Commission observed that the evidence and arguments of Gulf States ran afoul of numerous deeply-rooted policy considerations, perhaps the most prominent being the need to promote sanctity and stability of private contracts because they provide the foundational basis for wholesale power transactions. (Pet. App. at 24a) (citing *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 338, 344 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)). In *Pennsylvania Power & Light Co.*, the Commission offered the following explanation of some of the reasons underlying that policy goal:

> [W]e note that power supply arrangements are often negotiated on a long-term basis. It requires many years to build a generating plant and the building utility must be able to rely on long-term sales contracts in making its own capacity plans just as the purchasing utility must be able to rely on long-term contracts for stability of supply. Demand forecasts may change dramatically and quickly, as we have seen in recent years. The prudence of a sales arrangement, therefore, should be judged on

> the circumstances prevailing at the time such a contract is entered into. If a State commission, this Commission, or a utility itself could release a party to a contract from its contractual commitments simply because the contract, based on hindsight and demand forecasts in later years, no longer appears economical, the utility industry would have no supply stability or reliable basis for constructing plant.

23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325 (1983) (footnote omitted). *See also Western Massachusetts Electric Co.,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025 (1983); *Philadelphia Electric Co.,* 15 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,264 (1981).

Despite Gulf States' attempts to argue that the Commission's decision would negatively affect the "ability of the industry to attract capital" and would result in the "skewing of buy-versus-build incentives," (Pet. at 25), the obvious fact is that no utility could enter into a power sale contract if, as Gulf States would have it, that contract is subject to "abrogation" whenever the other party (or its state regulator) deems a "mismatch" of benefits and burdens to have developed thereunder. Nowhere does Gulf States explain how "mutuality of benefit" is maintained under a remedy that would require the customers and stockholders of Southern Companies to bear the cost responsibility that Gulf States once freely assumed but now wishes to shirk. Why would potential sellers of wholesale bulk power ever agree to make the billion dollar investment necessary to their performance under such contracts? The answer, of course, is that they would not.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit should be denied.

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